Testimony of John C. Partigan
Before the U.S. Senate Committee on Banking, Housing and Urban Affairs,
Subcommittee on Securities, Insurance, and Investment
Hearing on Capital Formation and Reducing Small Business Burdens

I. Introduction

Chairman Crapo, Ranking Member Warner, and distinguished members of the subcommittee, thank you for inviting me to testify.

I am a partner in the Washington, DC, office of Nixon Peabody LLP and the chair of the firm's national securities practice group. Prior to moving to Washington, I practiced securities law in Rochester, New York.

I have been practicing corporate and securities law for more than 25 years. I am a member of the District of Columbia Bar Association and the New York State Bar Association. I have served as a member of the NASDAQ Listings Qualifications Panel (2004–2014), and have advised public and private companies on a range of securities issues. I am a graduate of Albany Law School, J.D., and Willamette University, B.S.

I understand the Committee will examine a number of bills, and I of course, applaud your efforts to find bipartisan legislation addressing particular regulatory issues. I am here to speak on two related issues: (1) Wegmans Food Market, Inc.'s (Wegmans) support for S. 576, Encouraging Employee Ownership Act; and (2) how S. 576 updates the Securities and Exchange Commission's (SEC) Rule 701.

On behalf of Wegmans, I would like to thank Senators Toomey and Warner for introducing the Encouraging Employee Ownership Act. This bipartisan legislation will allow privately-held companies, like Wegmans, to continue to provide and expand ownership opportunities without having to risk the public release of competitively sensitive company information.

I have worked with Wegmans for more than 15 years, among other things assisting the company in its employee investment plan and the program design.

Wegmans is proud that a key component of its recruitment and retention efforts is designing programs that allow employees to share in the success of the company. The employee investment plan is one example of this shared success. In addition to sharing in the success, the program allows participants to build wealth. Finally, as is the case with many employee ownership programs, the Wegmans' program helps create an environment of innovation and loyalty.

II. About Wegmans

History

Wegmans is a privately-held, family-owned company. It is an American story. In 1916, John Wegman started his company with a produce push-cart. A year later his brother Walter joined

him in the operations. In 1921, John and Walter Wegman purchased the Seel Grocery Co. and expanded operations to include general groceries and bakery operations. Since its beginnings, Wegmans has remained, and will remain, a privately-held company.

Currently, Danny Wegman is CEO, and Colleen Wegman, his daughter, is president. Robert Wegman, Danny's father, was chairman until his death in April 2006. Wegmans operates 85 stores: 46 in New York, 16 in Pennsylvania, seven in New Jersey, six in Virginia (with the newest Wegmans set to open in Alexandria, Virginia, in June of this year), seven in Maryland, and three in Massachusetts. Wegmans employs almost 44,000 people.

Wegmans' Points of Pride

In February 2015, Wegmans was ranked number one for Corporate Reputation among the 100 most visible companies according to the Harris Poll Reputation Quotient (RQ®).[1] Wegmans is the only company to be ranked in the top five on all six reputation dimensions of social responsibility, emotional appeal, products and services, vision and leadership, financial performance, and workplace environment. Wegmans believes that its inclusion in each of these categories is a direct result of the dedication of its employees.

Every year since its inception 18 years ago, Wegmans has been ranked among FORTUNE magazine's 100 Best Companies to Work For, and has ranked among the top five for nine consecutive years—Wegmans is the only company in America that has accomplished this—and among the top 10 best companies to work for, for 11 consecutive years. As a result, Wegmans is in FORTUNE's Hall of Fame. In the recently released rankings, Wegmans was seventh on the 2015 FORTUNE list, and the number one retailer.[2]

Wegmans is extremely proud of this continued recognition and inclusion on the Best Companies to Work For, because it is a reflection of how the company treats its employees. Two-thirds of the scoring for the FORTUNE score comes from a survey that is both anonymous and random. The FORTUNE survey participants include Wegmans' full- and part-time employees, and employees from all of its facilities, including stores, warehouses, farms, offices, and manufacturing plants.[3]

Finally, and while I could go on, I will stop here with one final award note; a national consumer magazine recently ranked Wegmans as the best supermarket chain in the United States.

These accolades are the result of the dedication and efforts of Wegmans' employees, including many that Wegmans is trying to reward with ownership opportunities.

Wegmans, like other privately-held companies, has made the strategic decision to remain private. Wegmans has found this structure to be a competitive advantage as the company competes

[1] See, http://www.harrisinteractive.com/Insights/2015RQ100MostVisibleCompanies.aspx.

[2] See, http://fortune.com/best-companies/.

[3] Id.

against our country's largest grocery chains, companies like Wal-Mart/Sam's Club, Target, Giant, Kroger, Costco, Albertsons, SuperValu, and Whole Foods.

By remaining privately-held, Wegmans can focus on long-term results and customer service. This belief in the long-term nature of the company is manifest in its philosophy that if Wegmans takes care of its employees, its employees will take care of the customers, and the bottom line will take care of itself.

One example of this philosophy is the fact that Wegmans has never had a layoff.

Wegmans does not pay periodic bonuses. Rather Wegmans, like many privately-held companies, stresses the long-term decision making that leads to a stronger company, not just next quarter, or even next year, but in the next decade and beyond.

Allowing privately-held companies to provide ownership opportunities helps increase this long-term focus, which, in turn, creates a more engaged group of employees since they benefit directly from the company's long-term success. Even more important, programs like SEC Rule 701 allow privately-held companies to share the increased wealth from the success of the company rather than just keeping it in the hands of the company founders and families.

III. SEC Rule 701

Before I describe what S. 576 does, and why I believe it is a modest and sensible update to an already popular SEC rule, I want to provide a brief description of Rule 701 and its history.

Introduction to Rule 701: Why Was Rule 701 Created? How Does It Operate?

Rule 701, which was introduced in 1988, provides an exemption from SEC registration requirements, under the Securities Act of 1933, for private companies, private subsidiaries of public companies, and foreign private issuers to offer their own securities—including stock options, restricted stock, and stock purchase plan interests—as part of written compensation plans or agreements to employees, directors, officers, general partners, and certain consultants and advisors.

In the absence of Rule 701, many privately-held companies offering such securities would be required to register the sale of these securities with the SEC regardless of the fact that they are for compensatory purposes and not capital raising.

Rule 701 may be used only by an issuer that is not subject to the reporting requirements of Section 13 or Section 15(d) of the Exchange Act, and is not an investment company registered or required to be registered under the Investment Company Act of 1940.

The offer and sale of securities under Rule 701 must be for compensatory purposes, that is, the offer must be made pursuant to either a written compensatory benefit plan or a written contract relating to compensation established by the company or its parent or majority-owned

subsidiaries.[4] Rule 701 offerings are not used for capital raising purposes, but are, nevertheless, often an important component of companies planning to attract and retain talent – a key to the success of any business. This is particularly true of newer companies that may offer stock and stock options as they are attracting early-stage financing and need to preserve cash and demonstrate the commitment to the company of key employees.

Under Rule 701, the aggregate sales price or amount of securities sold or options granted in reliance on the rule during any consecutive 12-month period generally cannot exceed the greater of the following: (1) $1,000,000; (2) 15 percent of the total assets of the issuer, measured at the issuer's most recent balance sheet date; or (3) 15 percent of the outstanding amount of the class of securities being offered and sold in reliance on this section, measured at the issuer's most recent balance sheet date.[5]

A company must provide investors a copy of the compensatory benefit plan or the contract, as applicable. In addition, because the offering remains subject to SEC Rule 10b-5, the SEC's antifraud rules, a company must provide Rule 701 employee-investors with disclosure adequate to satisfy the antifraud provisions of the federal securities laws. Generally, this means that a company offering Rule 701 securities must adhere to a reasonable investor standard when determining the information provided to investors. In a nutshell, the reasonable investor standard is what disclosure information a reasonable investor would expect to receive from the company about the investment before making an investment in the company.

The Enhanced Disclosures

In 1996, the National Securities Markets Improvement Act ("NSMIA") was signed into law.[6] NSMIA included provisions that provide the SEC with unlimited Rule 701 exemptive authority. Prior to the enactment of NSMIA, the SEC was restricted to allow no more than $5 million per year for exempt transactions like Rule 701.

In 1999, when the SEC issued amended rules for Rule 701 under its new NSMIA authority, it created a new two-tier disclosure regime. For sales of $ 5 million and below, the existing 1988 disclosures requirements remained in place, with the SEC noting it "had not found instances of abuse of Rule 701, nor [had it] become aware of investor complaints. Rather, investors have enjoyed the benefits of being compensated with the securities of the company for which they are employed or provide services. Therefore, we have found that Rule 701 has been consistent with investor protection in the past."[7]

Nevertheless, because the SEC was expanding the program and had concerns that it was eliminating the $5 million cap, it created a regime of enhanced disclosure for yearly sales in excess of $5 million. These enhanced disclosures include: (1) a summary plan description if the

[4] See, https://www.sec.gov/rules/final/33-7645.htm.

[5] See, 17 C.F.R. § 230.701(d)(2).

[6] See, Pub. L. 104-290, 110 Stat. 3416 (October 11, 1996).

[7] See, https://www.sec.gov/rules/final/33-7645.htm.

plan is an ERISA plan or a summary of the material terms if it is not; (2) risk factors associated with the investment; and (3) financial statements, no older than 180 days, required under Regulation A.[8]

Why Is S. 576 Necessary?

S. 576 is a simple and balanced approach to raising this outdated threshold for the enhanced disclosures. Specifically, S. 576 instructs the SEC to increase the level, from $5 million to $10 million, at which the Rule 701 enhanced disclosures are required.

Simply put, any assertion that the enhanced disclosures are not burdensome or problematic is wrong. There are significant concerns about confidential information getting outside a privately-held company, while these disclosures provide little additional insight to employees.

The SEC noted in its 1999 rulemaking, "[b]ecause the compensated individual has some business relationship, perhaps extending over a long period of time, with the securities issuer, that person will have acquired some, and in many cases, a substantial amount of knowledge about the enterprise. The amount and type of disclosure required for this person is not the same as for the typical investor with no particular connection with the issuer."[9]

In the same rule-making, the American Bar Association, Subcommittee on Employee Benefits, Executive Compensation and Section 16 ("ABA Subcommittee") submitted comments expressing concern about the new disclosure requirements. The ABA Subcommittee stated that, "[m]ost private issuers keep confidential their financial conditions and results. Having to provide this information to employees (and often former employees) as a condition to the exemption risks having this information come into the possession of a company's competitors." The comments went on to note that, "[r]equiring that these employees be provided with financial information could result in serious injury to the company, one that it would be naïve to think could be avoided with a confidentiality agreement."[10]

Since 1999, when the ABA Subcommittee comments were submitted, the potential for leaks and the public release of highly confidential information has only grown. One need only to read the news to understand that organizations, including the U.S. government, struggle to keep sensitive data protected from hackers and dissemination.

Wegmans and other privately-held companies are faced with the decision whether to limit compensatory grants and sales to employees to stay under the $5 million enhanced disclosure threshold or risk the dissemination of highly confidential financial information.

---

[8] See, 17 C.F.R. § 230.701(e).

[9] See, https://www.sec.gov/rules/final/33-7645.htm.

[10] See, Comments of Task Force on Small Business Issuers and the Subcommittee on Employee Benefits, Executive Compensation and Section 16 of the Committee on Federal Regulation of Securities of the Section of Business Law of the American Bar Association, available at, http://www.sec.gov/rules/proposed/s7598/liftin8.htm; see also, Comments of David Greenlee, available at, http://www.sec.gov/rules/proposed/s7598/greenle1.txt.

Why Raise the Enhanced Disclosure Threshold to $10 Million?

If the disclosure threshold had been adjusted for inflation since 1988, it would be roughly $10 million today.[11] As the SEC noted in its 1999 rulemaking, the legislative history of NSMIA supported a prompt increase of the Rule 701 threshold to not less than $10 million.[12] Both the Senate Committee on Banking, Housing and Urban Affairs Report and the House of Representatives Committee on Commerce Report, suggested that Congress wanted the Rule 701threshold raised to not less than $10 million, and neither report makes mention of additional disclosures being a part of that increase. Finally, the most recently published SEC Government-Business Forum on Small Business Capital Formation included, among its recommendations, that the SEC "raise the dollar threshold for triggering the required disclosures pursuant to a Rule 701 offering from $5 million to no less than $10 million."[13]

This is what the Encouraging Employee Ownership Act would do. It is a sensible and balanced inflation adjustment that continues to address the SEC's original concerns by requiring disclosures for stock grants and sales above a certain level, while recognizing that employees know their companies.

IV. Conclusion

Wegmans and many of the nation's estimated 5.7 million[14] privately-held companies operate under the conviction that being privately held is the best model for them. It would be unfortunate to punish their employees by restricting their ownership opportunities because of a failure to update an outdated threshold. Privately-held businesses that want to offer additional ownership opportunities are stuck with a no-win decision: Do we risk losing good employees or do we risk the public release of our confidential business information? If Congress passes S. 576, the employee-investors of privately-held companies will benefit because their employers will no longer face this no-win decision.

Thank you again for the opportunity to testify today. I look forward to answering any questions that the Committee members may have.

---

[11] See, Bureau of Labor Statistics CPI inflation calculator, available at, http://www.bls.gov/data/inflation_calculator.htm, the purchasing power of $5 million in 1988 dollars is $10,005,748 in 2014 dollars.

[12] See, H. R. Rep. No. 104-622 at 38; S. Rep. No. 104-293 at 16.

[13] See, SEC Government-Business Forum on Small Business Capital Formation, Nov. 21, 2013, report available at, http://www.sec.gov/info/smallbus/gbfor32.pdf, pp. 14-15.

[14] See, http://www.forbes.com/sites/sageworks/2013/05/26/4-things-you-dont-know-about-private-companies/.